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China CITIC Bank

London Branch

Liquidity Risk Management Policy

Document History

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Version	Owner	Approval	Date	Major changes
1.0	President	President	May 2018	PRA Regulatory Business Plan
1.1	CRO	MANCO	Oct 2018	• Note to link to RAS and GRMF • Updated 'Regulatory Requirements – specific to 'whole-firm' level (SS1/17) • Delete reference to 2013 LCR calculation/requirement • Delete governance structure – refer GMRF • 3 lines of defense – specific to Liquidity Risk (refer GMRF for detail) • Systems & Controls – added reference to SYSC 7 • Liquidity Risk Appetite – deleted 90-day LCR and replaced with NSFR (added reference to Appendix 1 – Liquidity Risk Limits) • Moved 'Level 1' HQLA to Appendix 2 • Added 'Intra-day' stress scenario • Deleted 'rolling' spot FX and FX options • Add 'Review and Update of Policy' • Added Appendix 3 'Contingency Funding Plan'

CONTENT

1 Background

This document sets out the approach adopted by China CITIC Bank London Branch (“CNCBLB” and / or “the Branch”) for the management of liquidity risk.

For the purposes of this Policy, liquidity risk is defined as the risk that the Branch is unable to meet its financial obligations as they fall due. This may occur as a result of the Branch’s inability to:

- Meet its short-term lending commitments, rollover its short terms funding, or meet other contractual cash obligations; and
- Liquidate sufficient liquid assets, including marketable securities in a timely manner and acceptable price to meet all of its cash requirements.

Responsibility for managing the Branch’s liquidity, within the Risk Appetite Statement approved by the Management Committee (“ManCo”), ultimately rests with the ManCo but with day-to-day responsibility delegated to the Head of Financial Markets (“HoFM”).

2 Objectives

The overarching objectives of the liquidity risk management arrangements implemented for the Branch, which will manage its own liquidity position day-today, is to ensure liquidity risk is understood by relevant individuals, and that arrangements in place allow the risk to be identified, measured, managed, monitored and reported upon both locally in the Branch and to Head Office (“HO”).

The specific objectives of this policy are to:

- Provide overview of Regulatory requirements relating to CNCB LB liquidity risk requirements
- Document, at a high level, how the Branch manages liquidity risk;
- Assign ownership and accountability for the maintenance of the policy;
- Support the implementation of the Branch's Risk Appetite as it applies to liquidity risk management.
- Define the monitoring and reporting framework for managing liquidity; and
- Set out the Contingency Funding Plan

3 Policy Ownership/Oversight

The ’chain’ of ownership and oversight of this policy is set out below:

Document Owner	The Chief Risk Officer (“CRO”) is responsible for the maintenance for this policy reflecting oversight responsibilities for the Treasury Function. Any material changes to this policy must be formally signed off by the ManCo before these changes are communicated to staff.
Challenge	The Assets and Liability Committee (“ALCo”) will review and challenge this policy at least annually or more frequently as necessary. A recommendation for approval or otherwise must be made to the ManCo following each review. Reviews outside the annual cycle could be prompted by changes made to the President’s delegation of authority (“DOA”) from HO; or changing regulatory requirements.
Approval	ManCo reviews and challenges the policy based on the recommendation from ALCo. Not until it has been formally approved by ManCo will proposed changes take effect.
Applicability	All members of staff, whether permanent (local hires and/or expatriate) or contractors must operate in accordance with this policy. Escalation of any matters arising in respect of this should be via the individual’s Head of Department or directly to the CRO. To ensure compliance with the requirements of this policy the Risk Department as well as Internal Audit (“IA”) will conduct periodic reviews to ascertain compliance with the provisions of this policy.

4 Regulatory Requirements

The Branch is subject to the Prudential Regulation Authority's ("PRA") UK Liquidity regime as set out in Supervisory Statements SS10/14 and SS1/17. These provide an outline of the PRA's expectations of non- EU European Economic Area ("EEA") Branches operating in the UK in respect of liquidity risk management arrangements and state:

- Third-country forms liquidity will be managed at 'whole-firm' level;
- Liquidity Cover Ratio ("LCR") must be submitted on a semi-annual basis; and
- Reporting of LCR could be at a more frequent basis (at PRA request) and the firm must be able to provide liquidity information on a daily basis during stress.

General background to the wider UK Liquidity Regime, on 1 October 2015, the Commission Delegated Regulation (EU) 2015/61 ("the Delegated Act"), which sets out the details of the Liquidity Coverage Ratio ("LCR") came into force. At the same time, PS 11/15 revoked BIPRU 12 and set out new requirements for banks covering areas such as:

- The phase-in process for the LCR;
- Liquidity reporting and disclosure; and
- Liquidity risk management.

This information is provided for general information and should not be read as being directly applicable to the Branch, however, the principles and approaches described in the regulations have been considered in establishing the specific arrangements for liquidity risk management for the Branch.

5 Risk Management Framework

Liquidity Risk management forms and integral part of the overall risk framework, which is presented as follows:

CNCB (HEAD OFFICE)

HEAD OFFICE DELEGATED AUTHORITY
PRESIDENT CNCB LB

RISK APPETITE STATEMENT

RISK MANAGEMENT FRAMEWORK

RISK	PRIMARY RISK MANAGEMENT FRAMEWORK
CREDIT RISK	Credit Approval and Credit Risk Management Policy
MARKET RISK	Market Risk Management Policy
OPERATIONAL RISK	Operational Risk Management Policy Outsourcing Policy Business Continuity Management Framework New Products Approval Policy Conduct Risk Policy Framework
LIQUIDITY RISK	Liquidity Risk Management Policy

CNCBLB considers the cornerstone of liquidity risk management to be a robust overarching risk management framework ("RMF"), supported by clear policies and procedures.

This ensures compliance with both general regulatory requirements and with the Risk Appetite set by the ManCo. The key committees involved in liquidity risk management are ManCo; ALCo and

Audit and Risk Committee (“ARCo”). The ALCo maintains oversight of liquidity and is also responsible for reviewing and making recommendations to the ManCo on the liquidity risk management strategy. ALCo receives periodic Management Information (“MI”) predominantly from the Treasury but also from the Risk department periodically, which serves as the basis for its challenges and oversight.

6 Liquidity Risk Management

6.1 Three Lines of Defence

6.1.1 First Line of Defence

The Treasury team within Financial Markets will carry out all liquidity management activities on behalf of CNCBLB. The liquidity management activities undertaken are primarily in the following areas:

- Managing the day-to-day cash-flows to ensure CNCBLB can meet all its obligations;
- Ensuring that the Branch has correct funding levels; and
- Monitoring liquidity levels and if necessary resort to the ‘Contingency Funding Plan’ to ensure minimal disruption to CNCB LB business activities.

In addition, the Finance and Accounting Department prepares financial reports including in respect of trading activities. In doing so, it is responsible for analysis of profits / losses on these positions which it reports to ARCo and ManCo periodically.

6.1.2 Second Line of Defence

The second line oversight and support are provided by the Risk department ("Risk") and Compliance Department. Risk has day-to-day responsibility for overseeing the implementation of the Policy. It presents regular reports to ManCo on the Market Risk position of the Branch, limit utilisation and related issues.

Risk is also responsible for reporting the Liquidity Risk position of the Branch to HO through the functional 'dotted' line and ARCo reporting requirements.

6.1.3 Third Line of Defence

The third line is implemented through the Internal Audit function (which is an outsourced function) which conducts periodic assurance activities in respect of policy adherence as well as adequacy of the overarching Risk Management Framework.

6.2 Systems and Controls

The Branch will ensure it has systems and processes in place to identify, monitor and mitigate its Liquidity Risk. As per SYSC 7, Risk Control requirements; CNCBLB will have the following in place to identify, manage, monitor and report liquidity risk:

- Adequate risk management policies and procedures;
- Effective arrangements, processes and mechanisms to manage risk within tolerance levels;
- Effective measures to address deficiencies; and
- Relevant authorised persons to take responsibility of liquidity risk.

6.3 Sources of funding

The Branch’s main sources of funding are (in descending order of reliance):

- Borrowing from HO;
- Money market borrowing; and
- Corporate and Financial Institution Deposits.

In the event that the Branch intends to take funding from other sources, this policy will be updated to reflect any new funding sources.

6.4 Liquidity Risk Appetite

Liquidity risk is quantified in terms of stress tests applied to CNCBLB’s sources of funding, to account for the possibility that CNCBLB cannot raise funding from its normal sources, and to its cash inflows and outflows, to account for the risk that expected cash inflows may not occur or there may be unexpected draw-downs from committed facilities or under collateral arrangements, and the degree to which CNCBLB’s liquid assets can cover any shortfall in the ability of CNCBLB to meet its obligations.

The Branch’s approach to setting its Risk Appetite is to:

- Understand the significant risks to achieving its strategy;
- Establish a Risk Appetite; and
- Establish and communicate this appetite through the risk management framework.

The Branch will monitor its risk appetite against the following metrics:

- The liquidity ratio, defined as the balance of Branch liquid assets / Balance of Branch liquidity liabilities.
- Liquidity Coverage Ratio ("LCR"): the LCR considers short-term liquidity risk using a stress scenario in the 30-day maturity bucket. The outflows are stressed to 40% against inflows to calculate the net cash outflows. The net cash outflows in the 30-day maturity bucket are measured against CNCBLB's liquidity buffer to calculate the LCR.
- Net Stable Funding Ratio ("NSFR"): the NSFR ratio considers medium-term liquidity risk using stress scenarios in the amount of stable funding available against required stable funding, out to 1 year.

See ***Appendix 1*** – Liquidity Risk Limits (Risk Appetite)

The expression and accountability for the Branch's Risk Appetite will sit with the ManCo, who will delegate oversight for liquidity to the ALCo. Limits are set by ALCo on the three measures listed above, and will be managed by Treasury.

Furthermore, the type of securities in which investments for liquidity risk management purposes can be made include eligible loans and bond investments due within one month as well as readily realisable securities. For the readily realisable securities, given these are held with a view to access liquidity with a high degree of certainty and without incurring significant haircuts, even under stressed circumstances, the Branch will only invest in assets which are comparable to those defined as 'Level 1 Assets' under the Commission Delegated Regulation (EU) 2015/61 – see ***Appendix 2*** – Liquid Assets (Level 1).

6.5 Liquidity monitoring and reporting

A fundamental part of risk management is the need for robust and insightful management information ("MI") to serve as the basis for the appraisal and monitoring of risk positions. In the context of liquidity risk the Treasury department will perform a key role in the provision of MI both to ALCo and to ManCo.

In addition to the monitoring of the Risk Appetite metrics (see ***Appendix 1***), the Treasury department will be provided reports at least covering the following:

- The wholesale funding maturity profile of the Branch;
- CNCBLB funding spreads; and
- Liquidity Ratio, Liquidity Coverage Ratio and Net Stable Funding Ratio reports.

6.6 Management of Key Liquidity Risks

6.6.1 Off-balance sheet funding

Off-balance sheet risk is the risk that certain transactions or arrangements entered into that are not recorded on the Branch's balance sheet and which do not at present give rise to a certain known cash-flow, could under a stress give rise to unexpectedly high outflows, or materially contribute to an adverse liquidity position. In the case of the Branch, off-balance sheet risk arises in the form of pipeline of committed lending and from Letters of Guarantee as well as Letters of Credit.

6.6.2 Intra-Day Liquidity Management

Intra-day liquidity risk is the risk that the Branch is unable to meet its daily settlement obligations.

CNCBLB will ensure that it has sufficient liquidity at all times to maintain normal payment activity.

The Branch, through the Treasury department, will actively monitor and manage its intra-day liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions.

The Treasury function will forecast ahead to have sight of the likely deficit / surplus position at the start of day and therefore, will act in the market as required.

The Branch manages this risk through the following reports:

- Nostro / Correspondent Account reports;
- Daily payment / receipt forecasts and reconciliations; and
- Collateral and margin reports.

Appropriate MI is collated based on information gained from the above reporting to enable effective management and oversight of the Branch's intra-day liquidity risk.

6.6.3 Liquidity Resource/Funding Diversification

Funding concentration risk can arise where there are certain types of concentration within the Branch's funding profile (whether that is due to denomination of currency, geographic, or name specific) that can leave it vulnerable to substantial withdrawals in the event of a particular stress connected to that concentration.

The Branch will have exposure to a number of potential funding concentrations most notably to HO. Over time the combination of customer deposits, money market borrowing and possible CD/MTN issuance will increase the diversification of funding.

6.6.4 Liquidity stress testing

CNCBLB will carry out liquidity stress testing on at least an annual basis and more as required.

The stress tests will be applied to the Branch's current and projected balance sheet positions in order to inform ongoing compliance with Risk Appetite. Informing its stress scenarios and assumptions, the Branch shall be conservative in terms of both the maturity buckets in which liquidity flows are placed and the outflow or inflow factors applied.

In considering conducting its stress testing exercises, the Branch will consider four specific scenarios:

- Intra-day stress (behaviour analysis on cash in-flows and outflows)
- A 30-day idiosyncratic stress (LCR stress of outflows).
- A 90-day idiosyncratic stress;
- A 90-day market wide stress;
- A 90-day combined stress; and

For each scenario, a set of assumed outflow rates and asset haircuts will be applied.

6.7 Treasury Dealing

In order to ensure appropriate control over the activities of Treasury, the Branch will put in place and maintain appropriate Treasury Dealer Mandates to express the boundaries and thresholds for each trader exactly. These will be proposed by ALCo and approved by ManCo. The Mandates are reviewed and updated at least annually or more frequently as required.

6.7.1 Approved Treasury Instruments

The following is a list of approved instruments in which the Treasury Dealing staff can deal (subject to individual limits as defined within each dealers Treasury Dealing Mandate) for the purposes of hedging activities for the Branch (only client related trading activity is in respect of Spot FX).

Approved Treasury Instruments:

- Money Market deposits/placements
- Spot FX contracts;
- FX and IR Forwards;
- FX and IR Swaps;
- Government and corporate bonds/bills; and
- Bond repo and reverse repo.

6.7.2 Treasury Dealer Mandates

The following individuals within Treasury are authorised to deal in ‘Approved Treasury Instruments’

- The Head of Financial Markets; and
- Treasury Dealers.

In all cases the authorised personnel are only authorised to deal within the scope of their Treasury Dealer Mandates.

6.7.3 Oversight

Day-to-day dealing activities are supervised by Head of Financial Markets while the Internal Audit Plan will also include periodic reviews to provide assurance over adherence to this policy and the limits set through Dealing Mandates.

6.7.4 Dealing outside the office / office hours

Dealing outside the office or dealing outside office hours is not allowed unless a disruptive event occurs for example preventing physical access to the office.

In such an instance the Head of Treasury will seek approval for the Treasury staff to execute trades outside the office via remote access to relevant systems. Authority to execute one-off out of office trades may be given by the President or Vice President. ManCo can consider changes to this policy if the business needs require out-of-office trading (eg: 8 hours' time difference with HO) which may impact the Branch meeting the strategic objectives.

Any trading outside of the office must be recorded formally.

7 Review and Update of Policy

The Liquidity Risk Policy shall be reviewed by the Risk at least annually or as directed by the ManCo, to reflect changes in the profile of risks or business activities, organisational or authority structures or new regulations relevant to CNCB LB management of liquidity risk.

8 Appendix 1: Liquidity Risk Limits (Risk Appetite)

Risk Appetite		**Green (BAU)**	**Yellow (Pre-emptive Management action, if required)**	**Red (Invoke Liquidity Contingency Plan with decisive Management Action)**
Liquidity ratio ("LR")	Balance of Branch liquid assets / Balance of Branch liquidity liabilities	LR>40%	LR= Between 30% to 40%	LR <30%
One Month Liquidity Coverage Ratio	The Branch will ensure that it maintains cash inflows that could be generated from marketable securities can cover the cumulative liquidity requirement over 1 month.	LCR >90%	LCR = Between 75% to 90%	LCR< = 75%
Net Stable Funding Ratio	The Branch will ensure that it maintains cash inflows that could be generated from marketable securities can cover the cumulative liquidity requirement over 3 months.	LCR > 100%	LCR = Between 90% to 100%	LCR< = 90%

9 Appendix 2 – Eligible Liquid Assets (HQLA Level 1)

Specifically, the Branch will limit investments in assets held for liquidity risk management purposes to:

- Exposures to central banks within the EU, or other third countries which are assigned a credit assessment by a nominated external credit assessment institution ("ECAI") which is at least credit quality Step 1 (i.e. AA- rated and above);
- Assets representing claims on or guaranteed by certain central or regional governments, local authorities or public sector entities. This encompasses the central government, regional governments or local authorities of an EU Member State, or the central government, regional governments or local authorities of a third country, provided that it is assigned a credit assessment by a nominated ECAI which is at least credit quality step 1 (i.e. AA- rated and above); and
- Assets representing claims on or guaranteed by the following multilateral development banks and international organisations:
    - International Bank for Reconstruction and Development;
    - International Finance Corporation;
    - Inter-American Development Bank;
    - Asian Development Bank;
    - African Development Bank;
    - Council of Europe Development Bank;
    - Nordic Investment Bank;
    - Caribbean Development Bank;
    - European Bank for Reconstruction and Development;
    - European Investment Bank;

- European Investment Fund;
- Multilateral Investment Guarantee Agency;
- International Finance Facility for Immunisation;
- Islamic Development Bank;
- International Monetary Fund;
- Bank for International Settlements;
- European Financial Stability Facility; and
- European Stability Mechanism.

10 Appendix 3 - Contingency Funding Plan

The Contingency Funding Plan ("CFP") sets out the approach and actions CNCBLB will adopt in order to manage its liquidity position during stressed conditions. The objectives of the CFP are to ensure that:

- All CNCBLB's commitments can be met with minimal disruption to its business by ensuring liquidity stress situations are identified at an early stage so that action can be taken to prevent a more serious crisis developing;
- A clear crisis action plan exists and responsibilities for dealing with it are clearly identified;
- There is effective communication internally and with key external stakeholders; and
- The plan consists of the following elements:

1. Early warning indicators
2. Escalation procedures
3. Contingent Funding options
4. Action steps in responding to a liquidity crisis

1. <u>Early Warning Indicators</u>

CNCBLB has identified four indicator categories (Observed, Trend, Event and Systemic) that will be monitored for potential liquidity problems. Treasury have the primary responsibility of monitoring and they will also monitor market conditions for signs of distress in the banking sector, other sectors, and other geographic areas, which have the potential to impact the CNCBLB's liquidity. Other areas and individuals who have a role in liquidity management or who interact with funds providers should also rema in alert for indicators of market acceptance and confidence and should communicate pertinent information to Treasury as encountered.

The events listed below may indicate or confirm a potential or current threat to funding access. Along with management judgement, these indicators may establish the need for precautionary or corrective contingency funding action.

A. Observed Indicators

- Maturities not being re-offered;
- Awareness of negative rumours concerning CITIC Group circulating in the market;
- Media speculation about the strength of the CITIC Group;
- Awareness of any changes in risk profiles of peer & Chinese banks
- Requests from funds providers for early redemption of liabilities;
- Widening of CNCB bond prices in the secondary market relative to peer group;
- Breaching of any internal liquidity limits;
- Market intelligence and networking by Treasury and Marketing department;
- Pricing Reduced limits offered i.e. amount and tenor;
- Average tenor of third-party deposits decreases;
- Average tenor of third-party placements decreases; and
- Regulatory liquidity reports

B. Trend Indicators

- Asset quality deterioration; and
- Single or a series of negative bank analyst reports

C. Event Indicators

- Profit warning issued;
- Unexpected loss of executive management;
- Unexpected loss of major facilities or systems; and
- Default of counterparty

D. Systemic Indicators

- Developing loss of confidence in UK or Chinese banking system;
- General increase of illiquidity in wholesale markets; and
- Significant UK or Chinese bank failure

The main trigger is evidence of adverse changes in the behaviour of depositors.

2. Escalation procedures

The above four types of indicators will be monitored by Treasury and reported to the CRO and Vice President. If any indicators worsen or turn negative, this will be a trigger for discussion at the Asset & Liability Committee ("ALCO") and ManCo, an action plan will be implemented if necessary.

The CFP can be invoked by the President or CRO.

3. Contingent Funding options

- Initially the Head of Treasury will review positions at close of business the previous day. If there are significant liquidity concerns this will be escalated to the ALCO members
- ALCO members will review the assets and liabilities at the close of the previous day. The first exercise will be to verify the liquidity buffer and immediate maturing assets for cash flow purposes

- Next, ALCO will review any liquidity gaps taken by Treasury and agree a plan to reduce them where possible. Actions likely to be agreed will be selling any marketable securities as soon as possible and speaking to depositors to agree their intentions. Due to the nature and relationship that the bank has with the depositors this is deemed to a credible management action

Specific actions available to the committee will include:

- Advise CNCB HO treasury;
- Discussions with key depositors;
- Limit tenor of new inter-bank placements in order to reduce or eliminate any maturity gaps;
- Repo eligible liquid assets as necessary through the market or custodian;
- Dispose of selected liquid assets (other Bonds, short-term loans, etc);
- Freeze any asset acquisition;
- Advise the HO International Business Committee/Risk Committee of action taken and action plan put in place to rectify the liquidity position; and
- Advise the PRA of actions taken and provide an action plan to rectify the position

Testing the Plan

The CFP will be reviewed by risk department for operational effectiveness. Treasury will periodically test whether emergency funds can be borrowed using liquid assets in the repo market. The results of these tests will be documented and reported to the CRO.